Supreme Court, U.S.
FILED
NOV 24 2004

No. 04 732

In The

# Supreme Court of the United States

CITY AUTO SALES, LLC,

*Petitioner,*

v.

SHARON TAYLOR,

*Respondent.*

**On Petition For Writ Of Certiorari To The Supreme Court Of Tennessee, At Jackson**

## PETITION FOR WRIT OF CERTIORARI

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## QUESTION PRESENTED

Whether the Tennessee Supreme Court erred in deeming a standard arbitration clause, pursuant to the Federal Arbitration Act, in an Automobile Purchase Order Contract unconscionable where purchaser is exclusively limited to arbitration and the dealer may use judicial remedies for repossession and collection?

## LIST OF PARTIES

The parties to the proceeding are:

City Auto Sales, LLC, a limited liability company, neither publicly held nor having a parent company, on its behalf and on behalf of all person and entities similarly situated;

Sharon Taylor, an individual, and all persons similarly situated; and

Doug Butler, a named defendant, but no pleadings have ever been filed on his behalf.

## CITATIONS OF REPORTS OF OPINIONS ENTERED IN THIS CASE

*Sharon Taylor v. City Auto Sales, LLC* and Doug Butler, Tennessee Court of Appeals, W2002-01275-COA-R3-CV, April 24, 2003; and Supreme Court of Tennessee, 142 S.W. 3d 277, Tenn. Aug. 31, 2004. Appendix A.

## BASIS FOR SUPREME COURT JURISDICTION

The Tennessee Supreme Court entered its judgment on August 31, 2004. Petitioner, City Auto Sales, LLC, seeks review of that judgment on a writ of certiorari.

The petition is timely filed under 28 U.S.C. § 2101(c) and under Rule 13.1 and 13.3.

The U.S. Supreme Court has jurisdiction to review on a writ of certiorari the judgment of the Tennessee Supreme Court pursuant to 28 U.S.C. § 1257(a).

## STATUTORY PROVISION

9 U.S.C. § 2:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save

upon such grounds as exist at law or in equity for the revocation of any contract.

## STATEMENT OF THE CASE

On June 4, 2001, respondent, Sharon Taylor, ("Taylor") purchased a 1998 Pontiac Grand Am from petitioner, City Auto Sales, LLC ("City"), executing a Used Vehicle Retail Buyer's Order that included an arbitration provision requiring the parties to settle by binding arbitration, pursuant to the Federal Arbitration Act, 9 U.S.C. § 1, et seq., all claims, demands, disputes or controversies arising from the sale, lease or financing of the vehicle; provided, however, the dealer may pursue recovery and collection of debt due by state court action.

An action was filed in the Thirtieth Judicial District Chancery Court seeking rescission, return of down payment, loss of personal property when the vehicle was recovered by self-help, treble damages and attorney fees for violation of the Tennessee Consumer Protection Act and alleging fraudulent inducement to enter into the contract. On motion of City to dismiss based upon the arbitration clause, the motion was granted. Taylor appealed and the Tennessee Court of Appeals erroneously ruled that fraud in the inducement of a contract voided the contract rendering the arbitration clause unenforceable. Although the Tennessee Supreme Court properly ruled that fraud in the inducement of a contract should be arbitrated under the Federal Arbitration Act, the requirement of arbitration by Taylor and the allowance of state court remedies by City voided the entire arbitration requirement as to both dealer and purchaser.

## ARGUMENT

City asserts that the unconscionability of an arbitration agreement under the Federal Arbitration Act should be applied uniformly throughout the states. The dissenting opinion of Justice Holder crystallizes the need for a uniform standard. The language of 9 U.S.C. § 2 should be restricted to Federal Court interpretation only. To allow State Courts to determine unconscionability of an arbitration clause in an arbitration agreement under the Federal Arbitration Act renders the act ineffectual and thwarts the Congressional intent to resolve disputes without impeding commerce.

It is not unreasonable to request a conditional purchaser to forego arbitration when the recovery of a vehicle can be done expeditiously through State Court. The potential for depreciation, damage or disappearance is minimized. Nor is it unreasonable to allow a conditional dealer to seek collection through state remedies so as to avoid the duplicity, cost, and delay of enrolling an arbitration award in a State Court to execute on the arbitration award.

Had Taylor filed the same case in United States District Court, a different outcome would have occurred. In the case of *Harris v. Green Tree Financial Corp.*, 183 F.3d 173, 3rd Cir. 1999, the arbitration agreement allowed Green Tree to seek an action for judicial relief in a court to foreclose, to obtain monetary judgment or enforce the mortgage or deed of trust. The District Court found the agreement one-sided and unconscionable. The Court of Appeals discussed unconscionability defining it as a defensive contractual remedy to relieve a party from an unfair contract or an unfair portion. It requires a two-fold

determination: that the terms are unreasonably favorable to the drafter and no meaningful choice of the other party regarding acceptance. The Court of Appeals stated that the mere fact that Green Tree had the option to litigate certain issues when Harris must arbitrate does not make the arbitration agreement unenforceable. Inequality in bargaining power alone is not a valid basis to invalidate an arbitration agreement.

## CONCLUSION

City implores this Court to accept the writ of certiorari to decide whether State Court remedies for dealers in an arbitration agreement under the Federal Arbitration Act are enforceable or invalid uniformly.

Respectfully submitted,

JOSEPH D. BARTON, Attorney
ROGER A. STONE, Attorney

IN THE SUPREME COURT OF
TENNESSEE, AT JACKSON.
April 7, 2004 Session.

**SHARON TAYLOR v.**
**DOUGLAS BUTLER and CITY AUTO SALES.**

**Appeal by permission from the Court of Appeals, Western Section Chancery Court for Shelby County No. CH-02-0287-3 Hon. D. J. Allisandratos, Judge**

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**No. W2002-01275-SC-R11-CV – August 31, 2004.**

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We granted permission to appeal in this case to determine whether a claim for fraudulent inducement to a contract must be submitted to arbitration when the contract's arbitration clause covers "all claims, demands, disputes or controversies" and states that it is governed by the Federal Arbitration Act ("FAA"). We hold that parties may agree to arbitrate claims of fraudulent inducement despite prohibition of arbitration of such claims under Tennessee law, and because the parties in this case specifically agreed that the FAA governs the arbitration clause, they agreed to arbitrate the claim for fraudulent inducement of the contract. However, we also find that the arbitration clause in this case is unconscionable and therefore void because it reserves the right to a judicial forum for the defendants while requiring the plaintiff to submit all claims to arbitration. For these reasons, the trial court's dismissal of the complaint is overruled, and the decision of the Court of Appeals is affirmed.

**Tenn. R. App. P. 11 Appeal by Permission; Judgment of the Court of Appeals is Affirmed.**

WILLIAM M. BARKER, J., delivered the opinion of the court, in which FRANK F. DROWOTA, III, C.J., and E. RILEY ANDERSON and ADOLPHO A. BIRCH, JR., JJ. joined. JANICE M. HOLDER, J., filed a concurring and dissenting opinion.

Joseph D. Barton, Millington, Tennessee, for the appellant, City Auto Sales.

Sam F. Cole, Jr., Memphis, Tennessee, for the appellee, Sharon Taylor.

## OPINION

## FACTUAL BACKGROUND

On June 4, 1998, Sharon Taylor ("Taylor") purchased a car from City Auto Sales ("City Auto").[1] The parties signed a contract entitled "As Is Used Vehicle Retail Buyers Order" ("Buyers Order"). The Buyers Order provided that the total cost of the vehicle was $10,058.00. Taylor was to make a cash down payment to City Auto in the amount of $1,310.00 and finance the remainder. The Buyers Order contained an arbitration provision which stated that "all claims, demands, disputes or controversies of every kind or nature between [the parties] arising from the [sale of the vehicle] shall be settled by binding arbitration conducted

[1] Taylor also names Douglas Butler as a defendant in her complaint as a representative of City Auto. No separate allegations were made against Butler; he and City Auto were referred to collectively as "defendants." The Court of Appeals treated the defendants collectively. On appeal to this Court, only City Auto filed an application for permission to appeal.

pursuant to the provisions of the Federal Arbitration Act, 9 U.S.C. Section 12 et seq."

Taylor sold her car for $1,000.00 and used the proceeds therefrom as part of her down payment; she then signed a short-term promissory note agreeing to pay the remainder of the down payment over the following three months. City Auto delivered the vehicle to Taylor on the day the Buyers Order was signed. Taylor claims that City Auto told her at the time of delivery that her long-term financing had been approved. It is undisputed, however, that at the time of delivery, Taylor signed a separate "Spot Delivery Agreement." This agreement stated that City Auto was giving Taylor immediate possession of the car "pending the purchase of the installment sale agreement by a financing institution." The agreement also provided that, if proper financing could not be obtained within three days, City Auto would have the option to "immediately rescind the sale." Additionally, in the event that Taylor did not immediately return the vehicle, City Auto would "have the right to take immediate possession of the vehicle."

Approximately one week after the sale, City Auto notified Taylor that her application for financing had not been approved. When Taylor did not return the vehicle, City Auto repossessed the car along with personal items belonging to Taylor that were inside the vehicle at that time. City Auto retained possession of Taylor's personal belongings along with the $1,000.00 down payment.

Taylor filed suit against City Auto alleging a violation of the Tennessee Consumer Protection Act ("TCPA"), arguing that City Auto improperly obtained her $1,000.00 down payment and her personal property that was in the car by using deceptive tactics in violation of the TCPA.

Taylor also alleged that she was told that the Spot Delivery Agreement was "simply a formality and did not change the fact that she had already been approved for financing" on the sale of the car. City Auto responded by filing a motion to dismiss.

The trial court granted City Auto's motion to dismiss the complaint, holding that Taylor was bound by the arbitration provision in the Buyers Order. The Court of Appeals reversed the trial court, holding that a plaintiff cannot be compelled to arbitrate a claim pursuant to an arbitration provision that was fraudulently induced.

We granted City Auto's application to appeal to determine whether parties can be bound to arbitrate a claim for fraudulent inducement when the arbitration clause specifically states that it is governed by the FAA. On appeal, Taylor also raises the issue of whether the arbitration agreement is unconscionable because it reserves for City Auto the right to pursue judicial remedies while limiting Taylor to arbitration.

## ANALYSIS

### *I. Arbitration of Claim for Fraudulent Inducement*

The FAA applies to "a written provision in any maritime transaction or a contract evidencing a transaction involving interstate commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction." 9 U.S.C. § 2 (1994). The purpose of the FAA is "to ensure the enforceability, according to their terms, of private agreements to arbitrate." *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995) (quoting *Volt Info. Sci., Inc. v. Bd. of Tr. of Leland Stanford Junior Univ.*, 489 U.S. 468, 476 (1989)). Generally, arbitration

"should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage." *United Steelworkers of Am. v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582-83 (1960).

As the United States Supreme Court has stated,

> Arbitration under the [FAA] is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted.

*Volt Info. Sci., Inc.*, 489 U.S. at 479 (citations omitted). Therefore, the question becomes "what the contract has to say about the arbitrability of petitioner's claim." *Mastrobuono*, 514 U.S. at 58; *see also Frizzell Const. Co. v. Gatlinburg, L.L.C.*, 9 S.W.3d 79, 84 (Tenn. 1999).

In this case, the arbitration clause governs "all claims, demands, disputes or controversies of every kind or nature between [the parties] arising from the [sale of the vehicle]." The arbitration clause also states that arbitration shall be "conducted pursuant to the provisions of the Federal Arbitration Act, 9 U.S.C. Section 12 et seq." Furthermore, it contains the provision that the parties "agree that any question regarding whether a particular controversy is subject to arbitration shall be decided by the arbitrator."

When a contract is controlled by the FAA and contains a broad arbitration clause, claims of fraudulent inducement are subject to arbitration. *Prima Paint Corp. v. Flood*

*& Conklin Mfg. Co.*, 388 U.S. 395, 403-04 (1967). Specifically, the United States Supreme Court held that the language of the FAA "does not permit the federal court to consider claims of fraud in the inducement generally." *Id.* at 404. Instead, the court may address allegations of fraud only if they are directed to the arbitration clause itself. *Id.* at 403-04.

In the case under submission, the Court of Appeals found that the claim of fraud in the inducement was not subject to arbitration despite the holding in *Prima Paint.* The Court of Appeals relied upon *City of Blaine v. John Coleman Hayes & Assoc., Inc.*, 818 S.W.2d 33 (Tenn. Ct. App. 1991) and *Frizzell*, 9 S.W.3d at 85, as well as two unreported cases.

In *City of Blaine,* the Court of Appeals rejected the majority opinion in *Prima Paint* and held that the issue of fraudulent inducement could not be submitted to arbitration under the Tennessee Uniform Arbitration Act. 818 S.W.2d 33, 37-38 (Tenn. Ct. App. 1991). While recognizing that the FAA provides for arbitration of claims of fraud, the Court of Appeals interpreted the Tennessee arbitration statute as requiring judicial determination on the issues of rescission of the contract including fraud in the inducement. *Id.* Specifically, the Court found that there was no contract to arbitrate if the contract were procured by fraud. *Id.* at 37.

This Court has also held that claims of fraud in the inducement are to be resolved by the courts and not by an arbitrator when the contract is governed by Tennessee law. *Frizzell Constr. Co.,* 9 S.W.3d at 84. In *Frizzell,* the arbitration clause purported to govern "[a]ll claims, disputes and or other matters in questions arising out of, or relating to,

this Agreement." *Id.* at 81. In addition to this arbitration clause, the contract contained a clause stating that Tennessee law would form the basis for deciding questions concerning the contract's scope and interpretations. We held that:

> By stating that the contract is to be governed by Tennessee law, the parties have indicated their intention to arbitrate all disputes "arising out of, or relating to" their agreement – but only to the extent allowed by Tennessee law. . . . Therefore, because Tennessee law contemplates judicial resolution of contract formation issues, we conclude that the parties have indicated their intention not to submit such issues to arbitration.

*Id.* at 85.

The case under submission differs from *City of Blaine* and *Frizzell* in that both *City of Blaine* and *Frizzell* specifically provided that the laws of Tennessee would govern the arbitration of the contract. In contrast, the arbitration agreement in this case clearly states that it is to be governed by the FAA and not the Tennessee Uniform Arbitration Act. This distinction is important considering the long history in the federal courts of allowing arbitration of fraudulent inducement claims under the FAA, *see Prima Paint,* 388 U.S. at 402-05, even though Tennessee law prohibits the arbitration of such claims, *see Frizzell,* 9 S.W.3d at 84.

In *Frizzell,* we stressed that, in deciding whether a claim of fraudulent inducement is subject to arbitration, courts must focus upon the specific terms of the contract at issue. 9 S.W.3d at 84. We held that if the parties agreed to arbitrate the claim of fraudulent inducement, then despite such a prohibition under Tennessee law, the claim must be

submitted to arbitration. *Id.* The converse is equally true – if the parties did not agree to arbitrate the claim of fraudulent inducement, then they could not be compelled to arbitrate the claim despite the fact that the claim could be arbitrated under the FAA. *Id.*

It is undisputed that Taylor signed a contract that specifically stated that "all claims, demands, disputes or controversies of every kind or nature between [the parties] arising from the [sale of the vehicle] shall be settled by binding arbitration pursuant to the *provisions of the Federal Arbitration Act.*" (Emphasis added). Therefore, because Taylor knowingly signed the contract, she agreed to arbitrate a claim of fraudulent inducement.

## *II. Was the Arbitration Provision Unconscionable?*[2]

Taylor also argues that the arbitration agreement is void because it is unconscionable. She maintains that even if the contract was not induced by fraud, the terms of the arbitration provision are unconscionable because the contract reserves for City Auto the right to litigate claims it may have against Taylor while requiring Taylor to submit any of her claims to arbitration.

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[2] The dissent contends that the issue of unconscionability was waived because it was not raised until the case was before this Court, and therefore should not be considered. The majority agrees with the dissent to the extent that the pleadings are vague and unclear as to the issues raised by the pleadings. However, this appeal requires us to interpret the provisions of the contract, and the majority is of the opinion that we would not be doing justice in this case were we to consider only the duties and obligations of Ms. Taylor under the contract and not look to the rights and remedies available to the defendant.

### *A. Who Determines Whether the Arbitration Clause Is Unconscionable?*

In *Prima Paint,* the United States Supreme Court held that while claims of fraud are to be submitted to an arbitrator, claims that specifically attack the formation of the arbitration provision of a contract are to be judicially determined.

> Under [section] 4 [of the FAA], with respect to a matter within the jurisdiction of the federal courts save for the existence of an arbitration clause, the federal court is instructed to order arbitration to proceed once it is satisfied that 'the making of the agreement for arbitration or the failure to comply (with the arbitration agreement) is not in issue.' Accordingly, if the claim is fraud in the inducement of the arbitration clause itself – an issue which goes to the 'making' of the agreement to arbitration – the federal court may proceed to adjudicate it.

*Prima Paint,* 388 U.S. at 403-04 (internal footnote omitted).

Generally, whether a valid agreement to arbitrate exists between the parties is to be determined by the courts, and if a complaint specifically challenges the arbitration clause on grounds such as fraud or unconscionability, the court is permitted to determine it validity before submitting the remainder of the dispute to arbitration. 4 Am. Jur. 2d *Alternative Dispute Resolution* § 74 (2002 Supp.); *see also Burden v. Check into Cash of Kentucky, LLC*, 267 F.3d 483 (6th Cir. 2001); *N & D Fashions, Inc. v. DHJ Indus., Inc.*, 548 F.2d 722 (8th Cir. 1977); *Am. Safety Equip. Corp. v. JP Maguire & Co.*, 391 F.2d 821

(2nd Cir. 1968); *Hart v. McChristian*, 42 S.W.3d 552 (Ark. 2001); *Simpson v. Cohen*, 812 So. 2d 588 (Fla. App. 2002).[3]

In determining whether there is a valid agreement to arbitrate, "courts generally ... should apply ordinary state-law principles that govern formation of contracts," *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995). As the United State Supreme Court noted in *Allied-Bruce Terminix Cos. v. Dobson*:

> Section 2 [of the FAA] gives States a method for protecting consumers against unfair pressure to agree to a contract with an unwanted arbitration provision. States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.

513 U.S. 265, 281 (1995). "[G]enerally applicable contract defenses, such as fraud, duress, or unconscionability, may

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[3] While most courts have held that the question of whether an arbitration provision is valid is to be decided by a court, at least one jurisdiction has found that to be a question for the arbitrator. *See, e.g., In Re Conseco Fin. Servicing Corp.*, 19 S.W.3d 562 (Tex. App. 2000). In *In re Conseco,* the Texas court held that "whether the terms and conditions of an arbitration agreement are themselves unconscionable is a matter to be submitted to the designated arbitrator." 19 S.W.3d at 569. The Court explained that it was "sympathetic to" the plaintiff's complaints regarding the arbitration clause, but its "hands are tied" by precedent. *Id.* The Court went on to say that "[i]f we were writing on a blank slate, we would instead follow the Unites States Supreme Court's holding that 'generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements [by a court] without contravening' the enforcement provisions of the FAA." *Id.* n.3 (quoting *Doctor's Assoc., Inc. v. Casarotto,* 517 U.S. 681, 687 (1996)).

be applied to invalidate arbitration agreements without contravening" the enforcement provisions of the FAA. *Doctor's Assoc., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996).

As discussed above, Taylor's claim of fraud in the inducement is subject to arbitration under the FAA because that claim attacks the validity of the contract as a whole. However, her claim that the arbitration provision is unconscionable is a matter to be decided by the courts and not the arbitrator, because it specifically challenges the validity of the agreement to arbitrate irrespective of the validity of the whole contract.

*B. Is the Arbitration Provision in the Contract Unconscionable?*

In her brief on appeal, Taylor focuses on the following provision contained in the arbitration agreement of the Buyers Order: "Dealer, however may pursue recovery of the vehicle under the Tennessee Uniform Commercial Code and Collection of Debt due by state court action." Taylor asserts that this provision renders the contract unconscionable because City Auto has retained for itself legal remedies beyond arbitration while restricting Taylor to those remedies available under the Federal Arbitration Act.

The question of whether a contract or provision thereof is unconscionable is a question of law. *See Lewis Refrigeration Co. v. Sawyer Fruit, Vegetable & Cold Storage Co.*, 709 F.2d 427, 435 n.12 (6th Cir. 1983).

If a contract or term thereof is unconscionable at the time the contract is made, a court may refuse to enforce the contract, or may enforce the remainder of the contract

without the unconscionable term. *See* Restatement (Second) of Contracts § 208 (1981). "The determination that a contract or term is or is not unconscionable is made in the light of its setting, purpose and effect. Relevant factors include weaknesses in the contracting process like those involved in more specific rules as to contractual capacity, fraud, and other invalidating causes. . . . " Restatement (Second) of Contract § 208, cmt. a (1981).

Enforcement of a contract is generally refused on grounds of unconscionability where the "inequality of the bargain is so manifest as to shock the judgment of a person of common sense, and where the terms are so oppressive that no reasonable person would make them on the one hand, and no honest and fair person would accept them on the other." *Haun v. King,* 690 S.W.2d 869, 872 (Tenn. Ct. App. 1984) (quoting *In re Friedman*, 407 N.Y.S.2d 999 (1978)); *see also Aquascene, Inc. v. Noritsu Am. Corp.*, 831 F.Supp. 602 (M.D. Tenn. 1993). An unconscionable contract is one in which the provisions are so one-sided, in view of all the facts and circumstances, that the contracting party is denied any opportunity for meaningful choice. *Id.*

While Tennessee has yet to address the issue of whether an arbitration provision in a consumer contract which reserves a right to access to the courts only for the merchant and not the consumer is voidable on the basis of unconscionability, a number of other jurisdictions have addressed such one-sided arbitration provisions.

For example, the Supreme Court of West Virginia held that:

> [W]here an arbitration agreement entered into as part of a consumer loan transaction contains a

> substantial waiver of the borrower's rights, including access to the courts, while preserving the lender's right to a judicial forum, the agreement is unconscionable and, therefore, void and unenforceable as a matter of law.

*Arnold v. United Cos. Lending Corp.*, 511 S.E.2d 854, 862 (W. Va. 1998).

The Court in *Arnold* stated that "[a] determination of unconscionability must focus on the relative positions of the parties, the adequacy of the bargaining position, the meaningful alternatives available to the plaintiff, and 'the existence of unfair terms in the contract.'" *Id.* at 861 (quoting *Art's Flower Shop, Inc. v. Chesapeake & Potomac Tel. Co.*, 413 S.E.2d 670 (W. Va. 1991)). Applying this test, the Court noted that "the relative positions of the parties, a national corporate lender on one side and elderly, unsophisticated consumers on the other, were 'grossly unequal.'" *Id.* (footnote omitted). Additionally, there was "no evidence that the loan broker made any other loan option available to the Arnolds." Finally, the Court found that "the terms of the agreement are 'unreasonably favorable' to United Lending." Based on these reasons, the Court found the arbitration agreement to be unconscionable.

Similarly, the Montana Supreme Court voided as unconscionable an arbitration provision contained in a contract for advertisement in a telephone directory that reserved the right to a judicial forum for the Publisher for collection of amounts due while limiting the consumer to arbitration of all claims. *Iwen v. U.S. West Direct*, 977 P.2d 989 (Mont. 1999). The Montana Court held:

> [T]his case presents a clear example of an arbitration provision that lacks mutuality of obligation, is

> one-sided, and contains *terms that are unreasonably favorable to the drafter.* Because U.S. Direct presented this agreement on a take-it-or-leave-it basis, it is also a contract in which there was not meaningful choice on the part of the weaker bargaining party regarding acceptance of the provisions. . . . [D]isparities in the rights of the contracting parties must not be so one-sided and unreasonably favorable to the drafter, as they are in this case, that the agreement becomes unconscionable and oppressive.

*Id.* at 996; *see also Williams v. Aetna Fin. Co.*, 700 N.E.2d 859 (Ohio 1998), *cert. denied,* 526 U.S. 1051 (1999) (refusing to enforce an arbitration clause in a consumer loan contract which preserved for the finance company the judicial remedy of foreclosure on the debtor's mortgage but restricted the debtor's remedies solely to arbitration); *Lytle v. CitiFinancial Servs., Inc.*, 810 A.2d 643 (Pa. Super. Ct. 2002) (finding unenforceable an arbitration agreement that reserved access to the courts for CitiFinancial, absent "business realities" that would *compel* such a clause); *Showmethemoney Check Cashers, Inc. v. Williams*, 27 S.W.3d 361 (Ark. 2000) (finding that the arbitration agreement lacked mutuality because it provided for a judicial forum for one party while restricting the other party to arbitration).[4]

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[4] A minority of courts reach the opposite conclusion, holding that agreements to arbitrate which reserve certain judicial remedies to one party are not unconscionable. *See e.g., Stout v. J.D. Byrider,* 228 F.3d 709 (6th Cir. 2000) (upholding an arbitration agreement which exempted from arbitration disputes regarding buyer's failure to pay because buyer failed to show the agreement to be one of adhesion or sufficiently one-sided as to be unconscionable); *Conseco Fin. Serv. Corp. v. Wilder*, 47 S.W.3d 335 (Ky. Ct. App. 2001) (holding that the arbitration agreement

(Continued on following page)

The arbitration agreement in this case is comparable to those that were found to be unconscionable in the aforementioned cases. City Auto has a judicial forum for practically all claims that it could have against Taylor. Indeed, it is hard to imagine what other claims it would have against her other than one to recover the vehicle or collect a debt. At the same time, Taylor is required to arbitrate any claim that she might have against City Auto.

The contract signed between Taylor and City Auto is one of adhesion, in that it is a standardized contract form that was offered on essentially a "take it or leave it" basis without affording Taylor a realistic opportunity to bargain. *See* Black's Law Dictionary 40 (6th ed. 1990). We have previously determined that enforceability of contracts of adhesion generally depends upon whether the terms of the contract are beyond the reasonable expectations of an ordinary person, or oppressive or unconscionable. *See Buraczynski v. Eyring*, 919 S.W.2d 314, 320 (Tenn. 1996). Courts will not enforce adhesion contracts which are oppressive to the weaker party or which serve to limit the obligations and liability of the stronger party. *Id.* Looking at the arbitration agreement in the present case, it is clear that it is unreasonably favorable to City Auto and oppressive to Taylor. For these reasons, we find the arbitration clause in the Buyers Order to be invalid and unenforceable.

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was not unconscionable even thought it allowed the lender to pursue judicial enforcement of the security agreement). We find the majority view to be more persuasive.

Generally, a void agreement to arbitrate, incorporated in a general contract, is treated as a separate contract. 4 Am. Jur. *Alternative Dispute Resolution* § 77 (Supp. 2002) If the agreement is not a part of the substance of the general contract, pertains to the remedy only, and is collateral to the contractual matters, it is severable from the main body of the contract. *Id.* In Tennessee, "[a]n agreement can be either an entire contract or a severable contract according to the intention of the parties, and the fact that divisible parts are included within the same document does not preclude them from being considered and enforced as separate contracts." *Penske Truck Leasing Co. v. Huddleston,* 795 S.W.2d 669, 671 (Tenn. 1990).

Because the arbitration provision in the Buyers Order only relates to remedy and is collateral to all other contract matters, we find that it is severable from the remaining portions of the contract.

## CONCLUSION

In summary, we hold that a claim for fraudulent inducement was subject to arbitration in this case because the parties agreed in the Buyers Order to be governed by the FAA, and the FAA provides for arbitration of claims for fraud. However, we also find that the arbitration clause in the Buyers Order is unconscionable and therefore void because it reserves the right to a judicial forum for City Auto while requiring Taylor to submit all claims to arbitration. For these reasons, the decision of the Court of Appeals to overrule the trial court's dismissal of the complaint is affirmed, and the case is remanded to the

trial court for further proceedings consistent with this opinion.

Costs of this appeal are assessed to City Auto Sales.

WILLIAM M. BARKER,
JUSTICE

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JANICE M. HOLDER, J., concurring in part and dissenting in part.

I concur in the majority's holding that Taylor's claim for fraudulent inducement of the contract must be submitted to arbitration because the contract's arbitration provision covers "all claims, demands, disputes or controversies" and specifically states that it is governed by the Federal Arbitration Act. I write separately, however, because I disagree with the majority's decision to address the issue of unconscionability and with its conclusion that the arbitration provision in this case is unconscionable.

Unconscionability was not alleged in the pleadings, was not tried, and was not raised in the Court of Appeals. This line of argument appears for the first time in Taylor's brief to this Court. Therefore, I would hold that the issue was waived.

Moreover, even if the issue of unconscionability had not been waived, I disagree with the majority's conclusion that the arbitration provision in this case is unconscionable. The contract requires Taylor to arbitrate all of her claims against City Auto, while providing that: "Dealer, however may pursue recovery of the vehicle under the Tennessee Uniform Commercial Code and Collection of

Debt due by state court action." The majority concludes that this arbitration agreement is unreasonably favorable to City Auto and oppressive to Taylor. I am not persuaded by the majority's analysis.

In my view, the mere fact that there are different forums available to the parties in this case does not make the arbitration provision unconscionable. Other jurisdictions have held that an arbitration provision granting one party the option to litigate its claims while binding the other party to arbitrate all of its claims is not unconscionable. *See, e.g., Harris v. Green Tree Fin. Corp.,* 183 F.3d 173, 183 (3d Cir. 1999); *Pate v. Melvin Williams Manufactured Homes, Inc. (In re Pate),* 198 B.R. 841, 844 (Bankr. S.D. Ga. 1996); *Ex parte McNaughton,* 728 So. 2d 592, 599 (Ala. 1998); *Conseco Fin. Servicing Corp. v. Wilder*, 47 S.W.3d 335, 343-44 (Ky. Ct. App. 2001). A contract is unconscionable where the "inequality of the bargain is so manifest as to shock the judgment of a person of common sense, and where the terms are so oppressive that no reasonable person would make them on the one hand, and no honest and fair person would accept them on the other." *Haun v. King,* 690 S.W.2d 869, 872 (Tenn. Ct. App. 1984) (quoting *Brenner v. Little Red Sch. House, Ltd.*, 274 S.E.2d 206, 210 (N.C. 1981)). Although the arbitration agreement requires Taylor to arbitrate all of her claims while providing a judicial forum to City Auto for certain claims, in my opinion this lack of symmetry does not rise to the level of being shocking or unfairly oppressive. Instead, it is not unreasonable for Taylor to agree to forego arbitration of a claim, such as the recovery of a vehicle, that can be decided expeditiously in a judicial forum. *See Conseco Fin. Servicing Corp.*, 47 S.W.3d at 343. Furthermore, there is no basis to presume that arbitration will not afford Taylor

an adequate opportunity to present her claims. *See id.* at 344. I am of the opinion that the arbitration provision at issue should be enforced according to its terms. Therefore, I would affirm the trial court's dismissal of Taylor's complaint.

JANICE M. HOLDER,
JUSTICE

IN THE COURT OF APPEALS OF TENNESSEE
AT JACKSON
October 16, 2002 Session

**SHARON TAYLOR**
**v.**
**DOUGLAS BUTLER AND CITY AUTO SALES**

**An Appeal from the Chancery Court for Shelby County**
**No. CH-02-0287-3**

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**No. W2002-01275-COA-R3-CV**

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**JUDGMENT**

(Filed Apr. 24, 2003)

This cause was heard and regularly considered by the Court on the record, and for the reasons stated in the Opinion of this Court filed this date, it is **ORDERED** that:

1. The judgment of the trial court is reversed and the cause is remanded for further proceedings not inconsistent with this Opinion.

2. Costs on appeal are taxed to the appellees, Douglas Butler and City Auto Sales, for which execution may issue, if necessary.

**HOLLY KIRBY LILLARD, J.**
**W. FRANK CRAWFORD, P.J., W.S.**
**DAVID R. FARMER, J.**

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IN THE COURT OF APPEALS OF TENNESSEE
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**SHARON TAYLOR**

**v.**

**DOUGLAS BUTLER AND CITY AUTO SALES**

**An Appeal from the Chancery Court for Shelby County**
**No. CH-02-0287-3 D.J. Alissandratos, Chancellor**

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**No. W2002-01275-COA-R3-CV**

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(Filed Apr. 24, 2003)

This case involves the enforceability of an arbitration agreement. In June 1998, the plaintiff signed a contract to buy a used car from the defendant car dealership for approximately $10,000. In the sales contract, the plaintiff agreed to pay the dealership approximately $1,000 as a down payment on the car and finance the remainder. The sales contract included an arbitration provision. The plaintiff gave the dealership the down payment, and the dealership gave the plaintiff possession of the car pending final approval of the financing. Approximately a week later, the car dealership told the plaintiff that her application for financing had been rejected, and asked her to return the car. The plaintiff refused. The dealership then repossessed the car and kept the down payment and other personal property that the plaintiff had in the car. The plaintiff sued the dealership, claiming fraud, violation of the Tennessee Consumer Protection Act, and conversion. The dealership filed a motion to dismiss, arguing that the plaintiff's claims were subject to the arbitration provision

in the sales contract. The trial court dismissed the plaintiff's lawsuit, and the plaintiff now appeals. We reverse, finding that the plaintiff stated a claim for fraudulent inducement of the contract, which is not subject to the arbitration provision.

**Tenn. R. App. p. 3 Appeal as of Right; Judgment of the Chancery Court is Reversed and Remanded**

HOLLY KIRBY LILLARD, J., delivered the opinion of the court, in which W. FRANK CRAWFORD, P.J., W.S., and DAVID R. FARMER, J., joined.

Sam F. Cole, Jr., Memphis, Tennessee, for the appellant, Sharon Taylor.

Joseph D. Barton, Millington, Tennessee, for the appellees, Douglas Butler and City Auto Sales.

## OPINION

On June 4, 2001, Plaintiff/Appellant Sharon Taylor ("Taylor") sought to purchase a used 1998 Pontiac Grand Am from the Defendant/Appellee City Auto Sales ("City Auto"). The parties signed a document called an "'As Is' Used Vehicle Retail Buyers Order" ("Buyers Order"), reflecting that the total purchase price of the car was $10,058. The Buyers Order included an arbitration provision, stating that "all claims, demands, disputes or controversies of every kind or nature between [she and City Auto] arising from [the sale of the vehicle] . . . shall be settled by binding arbitration conducted pursuant to the provisions of the Federal Arbitration Act, 9 U.S.C. Section 12 et seq."

The Buyers Order also provided that Taylor agreed to make a cash down payment to City Auto of $1,310, and to finance the remainder.[1] To that end, Taylor sold her older car for $1,000 and gave that money to City Auto to satisfy part of her down payment. For the rest of the down payment, $310, Taylor signed a short-term promissory note agreeing to pay it in three equal installments over the following three months.

On that same day, pending approval of the long-term financing arrangement, City Auto delivered possession of the vehicle to Taylor. Taylor claims that City Auto told her at the time of delivery that the long-term financing had been approved. It is undisputed, however, that Taylor signed a "Spot Delivery Agreement," which stated that City Auto was giving her immediate possession of the car "[p]ending the purchase of the installment sales agreement by a financing institution." The Spot Delivery Agreement also provided that, if proper financing could not be obtained within three days, City Auto would be entitled "immediately to rescind the sale." Furthermore, upon City Auto's recission of the sale, Taylor would have twenty-four (24) hours from notice of the recission to return the vehicle to City Auto. If she did not return the vehicle, the Spot Delivery Agreement stated that City Auto would "have the right to take immediate possession of the vehicle."

After Taylor had had the car for about a week, City Auto told her that her application for financing had been

[1] Though the parties agree that Taylor's down payment was $1,310, the Buyers Order actually shows that the amount due from Taylor was $1,300. The $10 discrepancy, however, is immaterial to the issues in this appeal.

rejected. Consequently, City Auto demanded that she return the vehicle. Taylor refused. City Auto then repossessed the vehicle, along with other personal items belonging to Taylor that were in the car. According to Taylor, City Auto retained the $1,000 down payment and the personal items that were left in the car after the repossession.

On February 14, 2002, Taylor filed a lawsuit against City Auto. The complaint was entitled "Complaint for Damages for Violation of Tennessee Consumer Protection Act, for Fraud and Conversion."[2] In the complaint, Taylor alleged that City Auto improperly obtained her $1,000 down payment and her personal property that was in the car by using deceptive tactics in violation of the Tennessee Consumer Protection Act ("TCPA"), Tennessee Code Annotated § 47-18-112.[3] Taylor claimed that, when City Auto had her sign the incomplete Spot Delivery Agreement, she was

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[2] The complaint also named Douglas Butler as a defendant. The complaint does not explain who Butler is or his relationship to City Auto Sales, nor does it make any specific allegations against Butler separately. The complaint does not indicate whether Taylor intended to sue Butler individually or in a representative capacity. Rather, the complaint refers to Butler and City Auto Sales collectively as "defendants." Furthermore, the defendants have submitted only one brief on appeal for both parties. Taylor argues in her appellate brief that Butler is liable to her as an individual who participated in the fraud perpetuated by City Auto. The record reflects that Butler signed the $310 short-term promissory note, apparently on behalf of City Auto. The record contains no other evidence of involvement by Butler in City Auto's transaction with Taylor. Since there are no specific allegations against Butler in the complaint, it appears that Butler was sued as a representative of City Auto. Therefore, we will treat the defendants together, hereinafter referred to collectively as "City Auto."

[3] Taylor claimed that City Auto also retained the first month's premium payment for automobile insurance that she was required to pay upon receiving the car.

told "that her signing of the incomplete form was simply a formality and did not change the fact that she had already been approved for financing on their sale to her of the '98 [Pontiac Grand AM] anyway." Taylor asserted that, because City Auto's conduct constituted fraud, all transactions between her and City Auto were invalidated, and that City Auto improperly converted her property. Taylor sought $200,000 in damages as well as attorney's fees.

On March 27, 2002, City Auto filed a motion to dismiss the complaint based on the arbitration provision in the Buyers Order. City Auto asserted that Taylor's lawsuit was premised on breach of contract and that, therefore, her claims were subject to the parties' arbitration agreement. On April 26, 2002, Taylor filed a motion to strike City Auto's motion to dismiss, arguing that City Auto could not rely on an arbitration clause in a contract that it had elected to rescind. On May 17, 2002, the trial court entered an order denying Taylor's motion to strike the granting City Auto's motion to dismiss the complaint. From that order, Taylor now appeals.

On appeal, Taylor makes the same argument that she made in her motion to strike, i.e. that City Auto cannot rely on a provision in a contract that it has otherwise rescinded. Taylor maintains that her lawsuit is not premised on breach of contract. Rather, she has alleged that City Auto engaged in a fraudulent scheme and deceptive practices in violation of the TCPA. Finally, Taylor argues that the Spot Delivery Agreement is the contract at issue in this case, and that it did not include an arbitration clause. Consequently, she argues she is not obligated to arbitrate her disputes with City Auto. City Auto responds that Taylor's lawsuit is in fact premised on breach of contract, and that the Spot Delivery Agreement is subject

to the terms in the Buyers Order and, therefore, the arbitration provision in the Buyers Order applies to Taylor's claims.

Whether Taylor's claims are subject to the arbitration provision is an issue of law, which is reviewed *de novo*. ***See B.L. Hodge Co. v. Roxco, Ltd.***, No. 03A01-9704-CH-00144, 1997 WL 644960, at *2 (Tenn. Ct. App. Oct. 16, 1997). The trial court's findings of fact are reviewed *de novo*, with a presumption that those findings are correct unless the evidence preponderates otherwise. ***Id.***; Tenn. R. App. P. 13(d).

We first address Taylor's argument that the trial court erred in finding that she was bound by the arbitration provision in the Buyers Order because she alleges fraud, not breach of contract. Taylor notes that her complaint alleges a fraudulent scheme, including fraud in the inducement of the contract at issue. City Auto says that the arbitration provision in Taylor's contract was broad, providing for arbitration of "all claims . . . of every kind of nature" arising out of the sale at issue. Because of the breadth of that provision, City Auto argues that Taylor should be compelled to arbitrate all the claims raised in the lawsuit, including fraud, because they all relate to the sale of the vehicle.[4]

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[4] City Auto also argues that this case is governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1, *et seq.*, because the transaction at issue involved commerce. Because the FAA applies, City Auto argues, this Court must give weight to the strong federal policy favoring the enforcement of arbitration agreements. As we note above, however, the Tennessee Arbitration Act also reflects a strong legislative policy favoring arbitration. *Compare* Tenn. Code Ann. § 29-5-302(a) (2000), *with* 9 U.S.C. § 2 (1999).

It is well-settled in Tennessee that arbitration agreements are favored under the Tennessee Uniform Arbitration Act ("the Act") and should be given as broad a construction as the language of the agreement will warrant. ***See Buraczynski v. Eyring***, 919 S.W.2d 314, 317-18 (Tenn. 1996); ***Wachtel v. Shoney's, Inc.***, 830 S.W.2d 905, 908 (Tenn. Ct. App. 1991). Tennessee has recognized, however, that a plaintiff cannot be compelled to arbitrate a claim pursuant to an arbitration provision in a contract that was fraudulently induced. ***See River Links at Deer Creek v. Melz***, No. M2002-00043-COA-R3-CV, 2002 WL 31890897, *3 (Tenn. Ct. App. Dec. 31, 2002) (citing ***City of Blaine v. John Coleman Hayes & Assocs., Inc.***, 818 S.W.2d 33, 38 (Tenn. Ct. App. 1991)). Indeed, the Tennessee Supreme Court has held that "Tennessee law does not allow arbitration of contract formation issues." ***Id.*** (quoting ***Frizzell Constr. Co. v. Gatlinburg, LLC***, 9 S.W.3d 79, 85 (Tenn. 1999)). This rule of law is based on the premise that "[r]escission involves the avoidance or setting aside of a transaction." ***City of Blaine***, 818 S.W.2d at 38. If the contract should be rescinded based on fraudulent inducement, then "there is no contract containing an arbitration clause and the rights of the parties can be fully adjudicated by the court." ***Id.*** Consequently, if Taylor alleges fraud in the inducement, then that claim is not arbitrable and must be adjudicated by the trial court on its merits. ***See Spurling v. Kirby Parkway Chiropractic, Inc.***, No. 02A01-9609-CH-00225, 1997 WL 756684, at *1 (Tenn. Ct. App. Dec. 9, 1997).

An action for fraud in the inducement of a contract, also called promissory fraud, has four elements: (1) an intentional misrepresentation of a material fact; (2) knowledge of the falsity of that representation; (3) an

injury caused by reasonable reliance on the representation; and (4) involvement of a promise of future action with no present intent to perform. ***Dobbs v. Guenther***, 846 S.W.2d 270, 274 (Tenn. Ct. App. 1992) (citing ***Oak Ridge Precision Indus., Inc. v. First Tenn. Bank***, 835 S.W.2d 25, 28 (Tenn. Ct. App. 1992), and ***Stacks v. Saunders***, 812 S.W.2d 487, 592 (Tenn. Ct. App. 1990)). In averring any type of fraud, the plaintiff must state with particularity the circumstances constituting fraud. ***Spurling***, 1997 WL 756684, at *1. With those parameters in mind, we must look to the complaint to determine whether Taylor sufficiently alleges fraud in the inducement of the contract at issue. ***Id.***

The complaint first sets out the undisputed aspects of the sale at issue, stating that Taylor attempted to purchase the vehicle, and was required to pay a $1,310 deposit. It notes that Taylor sold her older car for $1,000 and paid that amount to City Auto as the bulk of her down payment. The complaint then avers that Taylor was given possession of the car, and that she drove it for over a week before City Auto repossessed it. At that point, the complaint details the allegedly deceptive circumstances and actions surrounding the signing of the Spot Delivery Agreement and City Auto's repossession:

> 5. That during the course of her dealings with the [City Auto] and [its] representations to her about inquiry into her credit history before she obtained possession and use of the '98 [Pontiac], they had they [sic] [Taylor] sign an incomplete form which they represented to her would be completed by them thereafter concerning her credit history. ***[Taylor] was told by [City Auto] that her signing of the incomplete form was simply a formality and did not change the***

***fact that she had already been approved for financing on their sale to her of the '98 [Pontiac] automobile anyway.***

6. That during the period of time that she drove and had possession of the '98 [Pontiac], [Taylor] placed a number of items of her personal property in the vehicle. ***Upon utilizing the vehicle as her newly purchased automobile for a week, [City Auto] informed [Taylor] that she was no longer approved for purchase of the '98 [Pontiac]*** and they demanded its return to them by [Taylor]. After refusing to return the '98 [Pontiac] to [City Auto] they then seized possession of it depriving her of it along with her items of personal property contained in that vehicle. [City Auto] also retained her $1,000.00 downpayment to them plus the insurance premium on the vehicle that she had also paid to [City Auto].

* * *

9. That [Taylor] charges and alleges that her above mentioned money and property were obtained from her by [City Auto] in their above described tactics and actions towards her in violation of the [TCPA], which prohibited [City Auto's] deceptive acts and practices against [Taylor].

10. ***That [Taylor] also alleges that [City Auto's] conduct and actions in reference to her purchase of the '98 [Pontiac] also constitute fraud thereby vitiating and invalidating their transactions with her.*** [City Auto has] likewise converted and retained her money and property to which they have no right whatsoever. [City Auto has] at no time ever sought or acted in any manner to return her

> funds or personal property to her any more than the '98 [Pontiac] automobile they sold to her.

Complaint (emphasis added). Thus, Taylor alleges that City Auto induced her into signing the Spot Delivery Agreement by telling her that she had been approved for financing, when she, in fact, had not been approved. She asserts that City Auto impermissibly retained her down payment and personal property after the repossession, which was a result of fraud that "invalidat[ed] [City Auto's] transactions with her."

After reviewing the complaint, we must conclude that it sufficiently states a claim for fraudulent inducement. Though not a model of clarity, the complaint's allegations were "sufficient to provide the defendants with fair notice of the nature of the claims made against them." ***Dobbs***, 846 S.W.2d at 274. Taylor seeks to show that City Auto induced her into signing the contract by falsely representing that her financing had been approved. She alleges either that the representation was false because her financing had actually not been approved, or if it had in fact been approved, City Auto later falsely represented that the financing was not approved. Regardless, Taylor's allegations set out a claim for fraudulent inducement which, if proven, would provide a basis on which Taylor could rescind the contract and the arbitration provision it contained. Moreover, Taylor's TCPA claims are based on the same allegations of fraudulent inducement. Therefore, those claims are also are not subject to arbitration. ***See Brown v. KareMor Int'l, Inc.***, No. 01A01-9807-CH-00368, 1999 WL 221799, at *2 (Tenn. Ct. App. Apr. 19, 1999) (noting that the TCPA allegation was not arbitrable because it did not "relate to the agreement"); ***but see Pyburn v. Bill Heard Chevrolet***, No. M2000-02322-COA-R3-CV,

2001 WL 487569, at *10 (Tenn. Ct. App. May 9, 2001) (distinguishing ***KareMor*** and determining that the TCPA claim in that case was "within the scope of what the parties agreed to arbitrate"). Accordingly, we must conclude that the trial court erred in holding that Taylor's claims must be arbitrated.[5] This holding pretermits all other issues raised in this appeal.

The decision of the trial court is reversed and the cause is remanded for further proceedings not inconsistent with this Opinion. Costs are to be taxed to the appellees, Douglas Butler and City Auto Sales, for which execution may issue, if necessary.

/s/ Holly Kirby Lillard
HOLLY KIRBY LILLARD,
JUDGE

[5] We emphasize that this holding in no way reflects this Court's opinion in regarding the merits of Taylor's claims. We merely adhere to the long-standing rule that allegations of fraudulent inducement are not arbitrable unless the parties specifically contract otherwise. ***See Frizzell Constr. Co. v. Gatlinburg, LLC***, 9 S.W.3d 79, 85 (Tenn. 1999)